

Below is a timeline of Senator Ted Kaufman's (D-Del.) major actions on market structure reform, in particular his repeated concerns about high frequency trading, systemic risks associated with algorithmic trading and possible market manipulation:

Aug. 21, 2009: Kaufman sends a letter to SEC Chairman Mary Schapiro calling for a **"comprehensive...review of a broad range of market structure issues"** and raising a series of questions about current market structure, including: **"Do our high frequency markets need high frequency safeguards against major machine malfunctions?"** Kaufman also asserts: "Opportunities for abuse that exploit the market structure should be subjected to a searching examination and review and possibly prohibited."

Sept. 10, 2009: Chairman Schapiro responds to Kaufman's Aug. 21 letter, recognizing the importance of standing up for the interests of long-term investors and agreeing to undertake a comprehensive review of market structure.

Sept. 14, 2009: Kaufman delivers a speech on the Senate floor emphasizing the need to study the "complicated and opaque" changes in market structure, including the explosive rise in high frequency trading, asserting: **"[U]nlike specialists and traditional market-makers that are regulated, some of these new high-frequency traders are unregulated, though they are acting in a market-maker capacity.**

They have no requirements to "maintain a fair and orderly" market. They trade when it benefits them. If we experience another shock to the financial system, will this new, and dominant, type of pseudo market maker act in the interest of the markets when we really need them? Will they step up and maintain a two-sided market, or will they simply shut off the machines and walk away? Even worse, will they seek even further profit and exacerbate the downside?"

Sept. 23, 2009: In a speech on the Senate floor, Kaufman applauds the SEC for beginning a broad review of the opaque, high-tech stock trading practices that in recent years have "fundamentally changed the way our markets operate." Kaufman also raises concerns about the potential systemic risks created by high frequency traders, asking: **"Do these high-tech practices and their ballooning daily volumes pose a systemic risk?"** and **"What do we really know about the cumulative effect of all these changes on the stability of our capital markets?"** Specifically, Kaufman notes: "In order to maximize speed of execution, many sponsored access participants **may neglect important pre-trade credit and compliance checks that ensure faulty algorithms cannot send out erroneous trades.**"

Kaufman concludes by saying: **"We cannot simply react to problems after they have occurred. We need the information and resources to**

identify problems before they arise and stop them in their tracks. But we cannot allow liquidity to trump fairness, and we cannot permit the need for speed to blind us to the *potentially devastating risks* inherent in effectively unregulated transactions.”

Oct. 16, 2009: Kaufman writes an op-ed in the *Financial Times* calling **high frequency trading a potential “systemic risk”** and proposes that regulators “develop more sophisticated statistical tests, such as following volume patterns to gain a granular view of gaming strategies. Only then can regulators separate high frequency strategies that add value to the marketplace from those that inexcusably take value away.”

Kaufman also notes: **“Left unchecked, high frequency trading could develop into a systemic risk, becoming simply too big and too fast to regulated. If all the machines ‘zig’ at the same moment when they should have ‘zagged,’ market chaos could ensue”**

Oct. 21, 2009: Commenting on the SEC’s dark pool proposals, Kaufman asserts: “Banning flash orders and imposing limits on dark pools should not be the end of the story...**Chief among the systemic issues that must be carefully reviewed is high frequency trading**, which now makes up over 70% of the daily market volume.”

Oct. 28, 2009: Kaufman testifies at Banking Subcommittee hearing on market structure issues, stating: **“First, we must avoid systemic risk to the markets. Our recent history teaches us that when markets develop too rapidly, when they are not transparent, effectively regulated or fair – a breakdown can trigger a disaster.”**

Nov. 5, 2009: Kaufman delivers a speech on the Senate floor entitled “Breaking the Boom-Bust-Bailout Cycle.” Kaufman asserts rapid technological change in the markets, combined with ineffective regulation and a lack of transparency, is **a recipe for disaster**. He also specifically **identifies the rise in high frequency trading as a systemic risk** and cautions that high frequency traders may be manipulating the markets absent adequate surveillance. Accordingly, Kaufman asserts: **“[T]he SEC must not let months go by without taking meaningful action. We need the Commission to report now on what it should be doing sooner to discover and stop any such high frequency manipulation.”**

Nov. 20, 2009: Kaufman sends a letter to Chairman Schapiro calling on the Commission to act quickly to “tag” high frequency trading activity and address the systemic risks they pose, stating: **“[W]e simply cannot permit high frequency practices to continue unchecked without the ability of regulators to observe and stop manipulation or to avert systemic risks.”**

Kaufman also states: “[T]ransparency, disclosure and risk-compliance requirements on the trading activities of high frequency traders are needed urgently. ... Moreover, because they are currently able to circumvent any meaningful regulatory checks, due to sponsored access and the lack of effective surveillance, the current situation is a prescription for disaster.” In conclusion, Kaufman asks the Commission to let him know “what specific actions the Commission can and should be taking right away to discover and stop market manipulation and the spread of systemic risk.”

Dec. 3, 2009: Chairman Schapiro responds to Kaufman’s Nov. 20 letter, asserting that the SEC is actively investigating potential market manipulation by high frequency traders, while agreeing with Kaufman that “improvements can and should be made” to “regulatory and surveillance mechanisms.” Chairman Schapiro also promises Kaufman that the SEC will issue a **concept release** in January and put forth two rule proposals that will **impose stricter trade reporting requirements on high frequency traders and address the risk of sponsored access arrangements.**

Jan. 13, 2010: The SEC issues a rule proposal **banning naked access** and also puts forth a concept release to solicit comments on high frequency trading and a number of other market structure issues, demonstrating that **the Commission is undertaking the comprehensive market structure review Kaufman requested in August.** Kaufman issues a statement reiterating the need for the SEC to “drill down beneath the standard-issue ‘provides liquidity’ defense of high frequency trading.”

Mar. 2, 2010: Kaufman returns to the Senate floor to discuss the rising chorus of regulators and market participants calling for increased transparency into high frequency trading practices. Kaufman urges the SEC to quickly implement tagging and disclosure of high frequency trading, then mask it and release it to the marketplace for academics and others to conduct independent empirical analysis.

Kaufman also calls on the SEC to “**make reducing systemic and operational risk a top regulatory priority.**” The SEC’s proposal on naked access is a good first step, but exchanges must also be directed to impose universal pre-trade risk checks. If left solely in the hands of individual broker-dealers, a race to the bottom might ensue. **We simply must have a level playing field when it comes to risk management that protects our equities markets from fat fingers or faulty algorithms. Regulators must therefore ensure that firms have appropriate operational risk controls to minimize the incidence and magnitude of such errors while**

also preventing a tidal wave of copycat strategies from potentially wreaking havoc in our equities markets.”

Finally, Kaufman encourages the high frequency trading industry to “come to the table” and play a meaningful role addressing current issues, noting: **“We all must work together, in the interests of liquidity, efficiency, transparency and fairness, to ensure our markets are the strongest and best-regulated in the world. But we cannot have one without the other – for markets to be strong, they must be well-regulated.”**

April 7, 2010: Following the SEC’s decision to consider a proposed rule to “tag” high frequency traders, Kaufman releases a statement applauding the SEC for moving forward with the proposed rule while stating the SEC should not let the data sit unused, explaining: “I further believe the Commission should mask the proprietary nature of this data and release it to the marketplace – or at least to academics and private analytic firms under ‘hold confidential’ agreements – so that independent analyses can be conducted on this data to assist the Commission in determining whether certain algorithmic trading strategies are illegal under existing anti-manipulation law.”

April 8, 2010: In a statement, Kaufman comments on the fines issued by the Financial Services Authority on three firms, Credit Suisse, GETCO and Instinet, for failing to provide accurate and timely transaction reports, stating: “The FSA has sent a strong no-nonsense message: Regulators must insist on receiving the data and transparency they need to detect abuses. Here in the U.S., I’m confident the Securities and Exchange Commission and FINRA will soon adopt the same attitude”

April 14, 2010: Kaufman issues a statement applauding the SEC’s unanimous vote to issue a proposed rule that would tag over 400 “large traders,” asserting: **“‘Large trader’ reporting, in conjunction with a consolidated audit trail, which three Commissioners discussed today, will substantially improve surveillance capabilities.**

But requiring broker-dealers to collect the data and the Commission examining it effectively are two different things. I want to learn more from the Commission about when and how they will analyze the ‘large trader’ data. We need active regulators and surveillance, not a passive system that permits data to pile-up in back offices.”

Kaufman also reiterates his belief that technological developments should not outpace regulatory understanding, saying: **“It is time to end the Wild West environment in which high frequency trading firms are unbounded by effective surveillance and the possible detection of any manipulative trading strategies. This is a start, but much more needs to be done.”**

May 6, 2010:

Commenting on the sudden drop and recovery in the stock market, Kaufman states: “I also have been warning for months that our regulators need to better understand high frequency trading ... **The potential for giant high-speed computers to generate false trades and create market chaos reared its head again today. The battle of the algorithms – not understood by nor even remotely transparent to the Securities and Exchange Commission – simply must be carefully reviewed and placed within a meaningful regulatory framework soon.**”